Supreme Court, U. S.
FILED
DEC 17 1976
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In the Supreme Court of the United States

OCTOBER TERM, 1976

NO. 76-861

M. RALPH CANNON
Petitioner

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEAL FOR THE FIFTH CIRCUIT

TO THE HONORABLE CHIEF JUSTICE AND HONORABLE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES

Your petitioner, M. Ralph Cannon, hereinafter referred to as petitioner, respectfully petitions this Honorable Court for a Writ of Certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit in No. 74-4150 rendered on June 21, 1976.

JURISDICTION

The judgment of the Court of Appeals denying a petition for rehearing was entered September 20, 1976. (Appendix A).

Jurisdiction is conferred by U.S.C.A. Title 28, Sec. 1254 (1).

OPINIONS

The memorandum findings of fact and opinion of the United States Tax Court is Appendix B.

The opinion of the Fifth Circuit Court of Appeals is Appendix C.

QUESTIONS PRESENTED FOR REVIEW

1. What legal effect should be given inconsistent tax assessments in a consolidated proceeding?

2. Does an arbitrary tax assessment lose its presumed validity?

3. Can and should credible evidence be disregarded and an equitable solution adopted in the absence of any factual basis?

STATEMENT OF THE CASE

The Commissioner of Internal Revenue made a determination that Idus P. Ash and M. Ralph Cannon each had earned unreported income of $64,680.00 during 1967. Each taxpayer filed a petition for redetermination of the alleged deficiency, the two cases were consolidated for trial, after which the Tax Court set aside the Commissioner's inconsistent position and divided the $64,680.00 equally between Ash and Cannon as income for tax purposes. The decision created a deficiency of $16,785.75 in income tax due from Cannon in 1967. Ash and Cannon appealed.

The Court of Appeals for the Fifth Circuit by a 2-1 decision affirmed the Tax Court. This Writ of Certiorari is to

review that decision as it applies to petitioner, M. Ralph Cannon.

On six occasions from October 5, 1967 to November 21, 1967 Joe H. Hodges of Houston, Texas sent Western Union money orders to Idus P. Ash in Dallas totalling $64,680.00. Hodges wired the money allegedly to place bets on football games. Ash claimed to be a conduit and estimated that petitioner received 90% of the funds as a bookmaker. Ash received a 10% commission from petitioner and also money from Hodges if he won. Ash did not report any wagering income in 1967 and failed to report admitted commissions he was paid by petitioner. Petitioner reported wagering income of $15,040.00 in 1967, of which $11,000-$12,000 came from Ash. Ash kept no records of money handled. Petitioner submitted periodic bank deposits as proof of wagering income.

There is no dispute that in 1967 Hodges wired $64,680.00 to Ash, Ash received the money orders and cashed them.

The only issue is how much, if any, of the $64,680.00 did Ash give to petitioner in order to determine taxable income for each man.

This is a case of first impression for the Court of Appeals which had never decided the legal effect of inconsistent assessments in a consolidated proceeding.

ARGUMENT

For the past thirty-eight years petitioner has been a businessman in Dallas operating a small variety store, bakery, grocery and delved in real estate. During 1967 petitioner reported an adjusted gross income of $28,315.93 which in-

cluded reported wagering of $15,040.00: he paid income tax of $8,745.33.

Idus P. Ash is a retired builder and developer living in Irving, Texas, a suburb of Dallas. Ash reported taxable income of $5,360.00 and paid $878.00 in income tax. Ash did not report income from wagering as a principal or the money he admitted receiving as an agent.

Joe Henry Hodges is a disbarred attorney living in Houston, Texas. Hodges is an admitted compulsive gambler with two federal felony convictions (1964, 1967) for embezzlement.

Hodges wired six Western Union money orders to Ash totalling $64,680.00 on six occasions from October 5, to November 21, 1967. It is undisputed that Ash did receive and cash all money orders. What happened to the money is the subject of this litigation.

Hodges testified that money was sent to cover bets on college and professional football games. Ash testified that the money was passed on to a bookie, alleging 90% had been given to petitioner.

Petitioner admitted receiving during 1967 between $11,000-$12,000 from Ash for wagering. Petitioner's bank deposits from wagering (in evidence) totaled $15,040.00. During the approximately seven weeks in question, petitioner deposited wagering income of $3,500.00. It should be noted that petitioner was in Europe with his wife three out of the seven weeks - from October 5, through October 26, 1967.

All wagering transactions were in cash. Ash kept no records of income or disbursements. Petitioner made ten cash bank deposits during 1967 amounting to $10,500.00 and at the end of the year had cash on hand of $4,540.00, or a total of $15,040.00 deposited and reported as wagering income.

Did Ash give Cannon any part of the money he received from Hodges? If so, how much? What is the proof?

After the money orders were admittedly received by Ash and cashed, the only specific testimony on what happened to a portion of the money is the self-serving testimony of Ash that 90% was given to petitioner. To testify otherwise would cause the money to become taxable income to Ash. Ash never said what happened to the other alleged 10%.

Hodges testified that all of the money he wired was lost and that during this seven week period he never collected any winnings (T 79).*

Any uninitiated person would question the extent of Hodges gambling activities being void of *any* winnings. The odds on such a possibility must be astronomical.

Hodges admitted embezzling approximately $400,000.00 during 1966 and 1967 which he used to gamble. Money during this two year period was also wired to Ash but no explanation was offered to its disposition (T 74).

Hodges did not know and had never spoken to petitioner until December, 1967. Hodges never saw Ash give petitioner money (T 68). Hodges testimony sheds no light and fails to corroborate what Ash did with the $64,680.00 cash during

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* (T - Tax Court Transcript).

October - November, 1967.

Two other witnesses testified. Jimmy George Wright, a realtor and lifelong friend of Ash, said he was present a few times when Ash delivered money to petitioner. No amount of money was specified nor the month or year when it happened. Wright's testimony does not substantiate any of the $64,680.00 being given to petitioner during October - November, 1967.

The other witness was Mrs. Ash. She testified her husband would pick up the money orders and give them to petitioner *or* to Hodges (T 43). She did not know when the money was allegedly given and did not know how much. She did testify that Ash went to the airport in Dallas to deliver money to Hodges, and Hodges went to her house to pick up money (T 44, 45). None of Mrs. Ash's testimony sheds light on any of the $64,680.00 being given to petitioner. Her testimony does bring out the interesting fact that Hodges went to Dallas to receive money from Ash. The testimony of Mrs. Ash and Wright fails to corroborate Ash.

Hodges, Wright, and Mrs. Ash were witnesses called by Ash in a vain and futile effort to substantiate his position as a conduit for the cash. Petitioner testified on his own behalf.

The testimony of Hodges has no value and is suspect at best. Hodges admitted that it was a fair statement he had no knowledge of how much money Ash might have kept or accepted personally as a bookie (T 64). Ash testified that he never advised Hodges how each bet was placed (T 70). Therefore, Hodges could not substantiate Ash's position that petitioner received any money.

It was admitted by Hodges, Mrs. Ash, Wright and Ash that

Hodges did fly to Dallas to pick up money from Ash. Ash even testified that the amount picked up by Hodges was more or less than $30,000 (T 21).

Various conflicts exist between the testimony of Ash and his witnesses. Ash said he received 10% of any winnings (T 12) and Hodges testified he had no agreement to pay Ash (T 75). Ash claimed that petitioner had seen and knew Hodges (T 25). Conversely, Hodges testified that he did not know petitioner, and talked to him only once in December, 1967 (T 86).

Under cross-examination by the respondent it was indicated that Hodges told the FBI that he was wiring money to cover gambling debts owed to Ash (T 73). Another question by the respondent indicated that Hodges told the FBI that he paid Ash 20% of his winnings (T 75). Hodges denied the percentage. Whatever statement Hodges made was in the possession of the Government, never introduced into evidence, and never furnished to petitioner.

Several possibilities come to mind as to the disposition of the $64,680.00. For instance, Hodges testified that he sent a money order to Dallas then picked up the cash and went to Las Vegas. Hodges admitted this could have been one of the six money orders (T 67). In fact, Hodges, Wright and Ash all testified that they made trips to Las Vegas together which were paid for by Hodges, including cash to gamble with (T 39, 40). Hodges went to Las Vegas 10 or 15 times in 1967 (T 86).

Another possibility for use of the cash are the references by Ash to "people" (T 11) and "other parties" (T 14). These were references when Ash allegedly placed bets for Hodges, and each reference is plural indicating a number of people

who received the money.

What Ash could have done with the $64,680.00 creates endless possibilities. The most obvious is that Ash was a bookmaker in 1966-67 when Hodges embezzled $400,000.00 which he forwarded to Ash (T 74). Also, because of the large amounts, Ash could have "laid off" bets with other bookmakers. It's easy to consider the probability that Hodges wired the money to Ash and some or all of it was later returned to Hodges and/or divided with Ash. Cash transactions cannot be traced and since neither Hodges or Ash kept records of any kind the embezzled funds could have been "laundered".

Hodges was assessed on the embezzeled $400,000.00 for tax purposes. The problem shifted to Ash to somehow show that even though he received the cash, it was passed on to others.

Two interesting documents were filed in the Tax Court by Ash. A "Motion for Leave to Amend Petition" (Appendix D) where on page 2, para. 3 the following is specified:

> "The first time Petitioners (Mr. & Mrs. Ash) or their counsel were able to discuss with Mr. Joe H. Hodges his testimony in this matter was on November 8, 1971, and said discussion was conducted in the presence of representatives of the Respondent. At such conference, it was revealed that the funds transmitted by Joe H. Hodges to Petitioners, and which are here sought to be taxed to Petitioners, had as their source, embezzelment by Joe H. Hodges from the Meyerland State Bank, Houston, Texas, and further that *the greater portion of the*

> *funds involved had been personally picked up from Petitioners (Ash) by Joe H. Hodges in Dallas, Texas, and taken to Las Vegas, Nevada for gambling, rather than being transmitted to persons in the Dallas, Texas area in payment of gambling debts or for purposes of wagering.* (Emphasis added) It was further revealed on October 8, 1971 the Internal Revenue Service had assessed against Joe H. Hodges federal income taxes with respect to all funds embezzled from the Meyerland State Bank, which funds were the same as those transmitted to Petitioners for Joe H. Hodges ".

The Motion to Amend was allowed and the Amended Petition filed by Ash (Appendix E) on page 2, para. 5(a) states:

> "Petitioners (Ash) received in 1967 Western Union money orders from Joe H. Hodges in the amount of $64,680.00. *These Western Union money orders were cashed and held by Petitioners for the benefit of Joe H. Hodges, and said funds were either subsequently picked up by Hodges or Hodges directed that Petitioners transmit the funds to other persons in payment of gambling debts or as wagers on behalf of Hodges.* (Emphasis added) Some part of such funds, the exact amount being unknown to Petitioners, was transmitted to one M. Ralph Cannon (petitioner herein) in payment of gambling indebtedness from Joe H. Hodges to M. Ralph Cannon or as wagers".

For some unknown reason these admissions by Ash were never mentioned during the Tax Court hearing or on appeal. (New counsel for petitioner on this Writ found them in the

record.) Apparently Hodges admitted to Ash or his attorney and some unnamed representative(s) of the Government that he personally received back "the greater portion of the funds", i.e. $64,680.00, which was gambled in Las Vegas and not given to "persons" in Dallas for gambling debts. This startling admission is totally inconsistent with the testimony of Hodges and Ash and smacks of perjury. To further discredit Ash, if there be a need, Ash testified that in 1967 he was paid commissions of approximately $4,000.00 from petitioner (T 29) which was not reported as income for tax purposes. (T 24)

Out of fear of over kill, attention is directed to the only time Hodges met and talked to petitioner. This occurred in December, 1967 after the embezzlement scheme of Hodges had surfaced. Hodges telephoned petitioner and said he needed $5,000.00 (T 30). Petitioner met Hodges near the Dallas airport and gave Hodges $5,000.00 with petitioner's intent that he was returning Hodges' money. (T 116, 117). Hodges told petitioner that he was in "big trouble" and that money had to be paid back to the bank if innocent people were not to get hurt (T 97).

Hodges admitted embezzling approximately $400,000.00 which he forwarded to Ash for gambling purposes. Petitioner admitted receiving and deposited $3,500.00 during the time Ash cashed the six money orders. If Hodges actually knew or even believed that petitioner had received the bulk of the $400,000.00, why then did Hodges only ask petitioner for $5,000.00? The $5,000.00 request is reasonably close to the amount petitioner reported as income - $3,500.00 - during October and November, 1967.

A Commissioner's determination is presumed to be correct and in Tax Court the burden of proof is on the taxpayer to

show that the determination is invalid. *Cohen v. Commissioner of Internal Revenue, 266 F. 2d 5 (9th Cir. 1959).*

The arbitrary double assessments against Ash and petitioner spotlights the Commissioner's position as a stakeholder seeking to protect its revenue. An assessment must have some factual foundation or it is obviously arbitrary. However, an arbitrary assessment is stripped of presumed validity. *Lucia v. U. S., 474 F. 2d 565 (5th Cir. 1973) (en banc); Bar L. Ranch, Inc. v. Phinney, 426 F. 2d 995 (5th Cir. 1970).*

In Bar L. Ranch, Inc. v. Phinney, supra, the Fifth Circuit said:

> "We therefore agree with the conclusion of the Court in *U. S. v. Lease* that a taxpayer defending a collection suit need only show that the Government's assessment was arbitrary and that the burden is then on the Government to show whether any deficiency exists and, if so, in what amount".

In the *U. S. v. Lease, 346 F.2d 696 (2nd Cir., 1965),* the Court concluded that the taxpayer had the burden to show only that the Government's computations are arbitrary, after which the burden is then upon the Government to show if any deficiency exists and in what amount.

When the Tax Court determined that the Commissioner's assessment against the petitioner was invalid, the Tax Court then assumed the responsibility to redetermine the deficiency. Therefore, the presumption as to the correctness of the Commissioner's determination was no longer valid. *Helving v. Taylor, 293 U.S. 507, 55 S. Ct. 287, 75 L. Ed. 623.*

The burden of proof, initially on the taxpayer, then shift-

ed to the Commissioner (Respondent) to establish any deficiency and the amount thereof. *Helving v. Taylor,* supra. Petitioner submits Respondent has failed to do so.

The case of *Greenfeld v. Commissioner, 165 F. 2d. 318 (4th Cir., 1947)* supports petitioner's position on a fairly parallel factual situation. In Greenfeld, the taxpayer was a "racing broker" and cashed bearer bonds given to him by a gambler to cover bets. Naturally the taxpayer testified he did not retain the money which was paid to bookmakers on behalf of the gambler. The taxpayer kept no books or records.

In *Greenfeld,* the taxpayer was the only witness; Ash was the only witness on his own behalf who could explain what happened to the $64,680.00 during October - November, 1967.

The Fourth Circuit pointed out in *Greenfeld* that many deficiencies appeared in the taxpayer's testimony, one of which was that he did not keep books or records of the bets. *Greenfeld* failed to produce proof he was not the owner of the proceeds and had no proof to show the distribution of the proceeds.

In the first paragraph of the Appellate Court's decision, it was erroneously stated that the $64,680.00 "was stipulated had been turned over to one or both of them for wagering in the tax year 1967". There is no stipulation herein that this money had ever been turned over to petitioner. It was stipulated that the $64,680.00 had been wired from Hodges to Ash and cashed by Ash. The reason for this litigation is that petitioner received only $11,000-$12,000 from Ash during the entire year of 1967 which was reported as taxable income.

CONCLUSION

Petitioner strongly urges that the Appellate Court disregarded the evidence, created a presumption, and without logic decided to "cut the baby in half" as taxable income. Circuit Judge Clark, in an excellent dissent, refused to adopt the "equitable" solution as being contrary to the law and the facts as established. The logic of petitioner's position was succinctly stated by Judge Clark:

> "If this were a true 'whipsaw' situation involving separate proceedings against competing taxpayers where no credible evidence bearing on allocation could be ascertained, we would be faced with a different and more difficult question. It is not. Even conceding that neither taxpayer's whole story was worthy of belief, *the Court had before it reliable proof constituting a rational basis for the distribution of liability. That proof consisted of clear documentation that Ash received the $64,680.00 and Cannon's admission that $12,000.00 of that sum was wagered with him".* (Emphasis added)

The elusive $64,680.00 evaporates once it comes into the hands of Idus P. Ash. That's where the buck should stop.

It is respectfully submitted that the decision of the Court of Appeal for the Fifth Circuit and the Tax Court should be reversed setting aside $32,340.00 as taxable income to M. Ralph Cannon for 1967.

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Telephone: (504) 522-7446

CERTIFICATE

Copies of the above Writ of Certiorari were mailed to Peter Winstead, Counsel for Idus P. Ash, 2001 Bryan Tower, Suite 2680, Dallas, Texas 75201 and Scott P. Crampton, Assistant Attorney General, U.S. Department of Justice, Counsel for the Commissioner of Internal Revenue, Washington, D.C. 20530, this 16th day of December, 1976.

Denis A. Barry

DENIS A. BARRY

United States Court of Appeals
FIFTH CIRCUIT

EDWARD W. WADSWORTH
CLERK

OFFICE OF THE CLERK

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NEW ORLEANS, LA. 70130

September 20, 1976

TO ALL COUNSEL OF RECORD

Nos. 74-4150 - M. Ralph Cannon vs. Commissioner of Internal Revenue
75-1143 - Idus P. Ash & Georgia L. Ash vs. Commissioner of Internal Revenue

Dear Counsel:

This is to advise that an order has this day been entered denying the petition( ) for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition( ) for rehearing en banc has also been denied.*

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH, Clerk

By Clare F. Sachs
Deputy Clerk

cc: Messrs. Lester L. May ✓
Kenneth A. Herridge ✓
Mr. Scott P. Crampton
Mr. W. John Howard, Jr.
Mr. W. Mike Baggett
Mr. Meade Whitaker

* Clark, Circuit Judge, dissenting from the refusal to grant the petition for rehearing for the reasons set out in his dissent to the panel's opinion.

T. C. Memo. 1974-219

UNITED STATES TAX COURT

IDUS P. ASH and GEORGIA L. ASH, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

M. RALPH CANNON, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 360-71, 6102-71. Filed August 26, 1974.

Peter Winstead, for petitioners in docket No. 360-71.

Lester L. May, for petitioner in docket No. 6102-71.

W. John Howard, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, Judge: Respondent determined deficiencies in the petitioners' Federal income tax as follows:

Docket No.	Petitioner	Taxable Year	Amount
360-71	Idus P. Ash and Georgia L. Ash	1967	$27,305.86
6102-71	M. Ralph Cannon	1967	36,993.48

The cases were consolidated for trial and opinion. The sole issue is the amount of income not reported by one or both of petitioners. Respondent is in the position of a stakeholder by his determination of identical deficiencies against petitioners.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulations of facts and exhibits are incorporated by reference.

Petitioners Idus P. Ash (hereinafter referred to as Ash) and Georgia L. Ash resided in Irving, Texas, when they filed their petition. Their joint Federal income tax return for the taxable year 1967 was filed with the district director of internal revenue at Dallas, Texas.

Petitioner M. Ralph Cannon resided in Dallas, Texas, when he filed his petition. His Federal income tax return for the taxable year 1967 was filed with the district director of internal revenue at Dallas, Texas. During the taxable year, Cannon operated a variety store and bakery shop and participated in real estate transactions. On his return for the taxable year 1967, Cannon reported as miscellaneous wagering income the sum

of $15,040 computed on cash deposits to his bank account as follows:

Detail	Date of Deposit	Amount
Cash deposit	2/24/67	$ 1,000.00
Cash deposit	4/28/67	1,500.00
Cash deposit	5/ 1 /67	500.00
Cash deposit	6/21/67	1,000.00
Cash deposit	7/26/67	3,000.00
Cash deposit	10/13/67	500.00
Cash deposit	10/17/67	500.00
Cash deposit	10/25/67	500.00
Cash deposit	11/21/67	1,000.00
Cash deposit	11/22/67	1,000.00
TOTAL CASH DEPOSITS		$10,500.00
CASH NOT DEPOSITED		4,540.00
TOTAL		$15,040.00

Ash was in the general contracting business and reported no wagering income on the income tax return he filed with his wife.

During the taxable year 1967, Ash received Western Union money orders from Joe H. Hodges totaling $64,680. The funds transmitted by money orders had been embezzled and swindled by Hodges from Meyerland State Bank in Houston, Texas. The money orders were as follows:

Date of Money Order	Amount	Details
10/ 5 /67	$ 3,700.00	Delivered to IDUS P. ASH, 1003 So. Highschool Lane, Irving, Texas, and cashed at Irving Bank and Trust Company, Irving, Texas, on 10/9/67
10/21/67	6,600.00	Draft signed for by IDUS P. ASH. Cashed at Irving Bank and Trust Company, Irving, Texas, 10/23/67

Date of Money Order	Amount	Details
10/28/67	$12,300.00	Paid in cash by Western Union, Dallas, Texas. Draft endorsed by IDUS P. ASH. Notation on draft: "Known customer - PW - Sex M."
11/10/67	13,200.00	Paid in cash by First National Bank in Dallas, Texas. Draft endorsed by IDUS P. ASH.
11/18/67	12,680.00	Draft endorsed IDUS P. ASH and paid in cash by Western Union, 10:43 a.m., 11/20/67.
11/21/67	16,200.00	Paid in cash by Western Union. Receipt signed by IDUS P. ASH.

Hodges wired the money to Ash on Fridays so that bets might be placed in Dallas on college and professional football games to be played on the upcoming weekend. Ash required that the cash be sent to Dallas before he would place the bets. After allowing time for Ash to receive the funds, Hodges would telephone him and obtain the "point spreads" on the various games. After deciding upon his bets, Hodges would telephone Ash again and place his bets. Ash would bet a portion of Hodges' money with Cannon. Since it was Hodges' understanding that Ash was to "lay the bet off" with a bookmaker, Hodges would call Ash a third time and obtain confirmation that the bet had been placed by Ash. Hodges never bet directly with Cannon.

The money wired to Ash was not intended by Hodges to be applied toward past gambling debts owed Ash or for bets on future weekends. During the taxable year 1967,

Hodges owed no gambling debts to Ash. There was no agreement between Hodges and Ash as to a fee or commission for placing the bets. Hodges would, however, occasionally give Ash a portion of his winnings.

Ash was introduced to Cannon in 1966 when Ash was seeking a horse racing bookmaker. Ash began to gamble with him and the two men spent time together gambling in Hot Springs, Arkansas, and Ruidoso, New Mexico. In 1966, Ash attempted to persuade Cannon to purchase real estate with him in Dallas but Cannon declined. When Cannon and another purchased a tract of land near the land Ash offered, Cannon borrowed $10,000 from Ash and provided Ash with collateral in an equal amount to make it appear to his estranged wife that he was in poor financial condition. The loan was never repaid.

Pursuant to his arrangement with Cannon, Ash was paid a 10 percent commission of the net winnings from bets which he placed with Cannon. The commissions were not paid directly to Ash but were deducted by Ash from amounts he paid over to Cannon. Ash placed bets with Cannon for himself and for others besides Hodges.

Ash never identified Cannon to Hodges as the bookmaker with whom he placed Hodges' bets. Hodges assumed

that Cannon was the bookmaker but he had no knowledge of the amount which Ash bet with Cannon. It was Hodges' intention and understanding that Ash was to bet the money for him and that none of the money was to be retained by Ash as compensation. On one occasion in 1966 or 1967, Hodges accompanied Ash to Cannon's variety store while Hodges' money was delivered to Cannon but Hodges remained in the automobile as Ash delivered the money to Cannon in the store. On another occasion, Hodges was present in Ash's kitchen when Ash called to place Hodges' bet with a person whom Hodges thought to be Cannon.

Hodges communicated directly with Cannon on only two occasions. In October or November 1967, Hodges contacted Cannon by telephone and informed him that the money which Ash was losing had been stolen from a bank and the money had to be returned or innocent people would be hurt. Hodges requested that Cannon give him the sum of $5,000 and indicated to Cannon that this would solve his difficulties with the bank. Being willing to give Hodges "anything" to prevent embarrassment to his mother and daughter, Cannon gave Hodges the requested amount in cash in December 1967 at a motel near the Dallas airport and received the following statement from Hodges:

To Whom It May Concern:

This letter is an admission that I have today received from Ralph Cannon the sum of $5,000 in cash. I have accepted this money in return for a promise not to cause him any unfavorable publicity of any kind, either spoken or written, which might embarrass or humiliate him or his mother and daughter in any way.

Signed,

/s/ Joe H. Hodges

During the 1967 football season, Hodges sustained losses of approximately $200,000 as a result of his gambling transactions with Ash. Over the two years, 1966 and 1967, he sustained losses of approximately $400,000 as a result of his gambling transactions with Ash. On two occasions during 1967, Hodges took Ash to Las Vegas with him. In addition to buying Ash's airplane ticket, Hodges gave Ash money with which to bet.

Neither Ash nor Cannon retained any books or records of the cash received or paid out in connection with their gambling activities. Cannon's net winnings from gambling were kept in a shoe box and periodically deposited in his bank account. The $5,000 given to Hodges by Cannon was taken from the shoe box and was not reported as income on Hodges' 1967 Federal income tax return. Cannon did not file a Federal excise tax return for wagering income for the taxable year 1967. He did not possess a Federal wagering tax stamp during that year.

In notices of deficiency mailed to petitioners, the Commissioner determined that petitioners Ash and Cannon each failed to report on their Federal income tax returns for 1967 the amount of $64,680 as gambling income.

OPINION

The sole issue is the amount of unreported gambling income received by Ash and/or Cannon during 1967.

There is no dispute that Hodges wired $64,680 to Ash in 1967 for wagering. To the extent that Ash transferred the funds to Cannon, the income is not taxable to Ash.

The record in this case is unsatisfactory. Neither Ash nor Cannon had records to prove the amounts of cash they handled. The testimony of each was vague, unconvincing and entitled to little weight. The testimony of other witnesses lent little support to the contentions of either Ash or Cannon. The activities of both Ash and Cannon were illegal and the money that changed hands was embezzled from a bank. The $5,000 paid from Cannon to Hodges resembles "hush money."

Given such a record, we conclude that both parties failed to prove how much income they earned as a result

of their illegal gambling activities with Hodges' ill-gotten gains. Respondent admits an inconsistent position and acts as a stakeholder. It would, therefore, seem inappropriate to tax both Ash and Cannon on the entire $64,680. Accordingly, we hold that Ash and Cannon each earned one-half of the total sent from Hodges to Ash, or $32,340.

Decisions will be entered in docket Nos. 360-71 and 6102-71 under Rule 155.

M. Ralph CANNON, Petitioner-Appellant, Cross-Appellee,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee, Cross-Appellant.

Idus P. ASH and Georgia L. Ash, Petitioners-Appellees, Cross-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellant, Cross-Appellee.

Nos. 74-4150, 75-1143.

United States Court of Appeals, Fifth Circuit.

June 21, 1976.

Two income tax payers appealed from a decision of the tax court which determined that each of them earned one-half of a total of $64,680 which had been turned over to one or both of them for wagering. The Court of Appeals, Tuttle, Circuit Judge, held that the tax court's determination was not erroneous absent evidence to the contrary presented by the taxpayers.

Affirmed.

Clark, Circuit Judge, filed a dissenting opinion.

1. Internal Revenue ⇐1525

Tax court's determination that each of two income tax payers earned one-half of sum which had been turned over to one or both of them for wagering was not erroneous absent evidence to the contrary presented by taxpayers.

2. Internal Revenue ⇐514

Where income tax payer received money from embezzler for use in gambling activities, entire sum was taxable and sum voluntarily returned to embezzler in nature of "hush money" was not deductible.

Appeals from the Decisions of the Tax Court of the United States (Texas Cases).

Before TUTTLE, AINSWORTH and CLARK, Circuit Judges:

TUTTLE, Circuit Judge:

This is an appeal from a decision of the Tax Court which determined that each of the petitioners earned one-half of a total of $64,680 which it was stipulated had been turned over to one or both of them for wagering in the tax year 1967. The petitioners, neither of whom kept any records covering their extensive wagering operations, both claim that the Tax Court's Solomon-like decision, (I Kings 3:16–28) to cut the baby in half, was not supported by the evidence and must therefore be set aside.

[1] It is undisputed that one Joe Hodges of Houston, Texas embezzled from a state bank, so far as is of importance in this litigation, the sum of $64,680 during the two months of October and November in 1967 and that he delivered that amount by means of six drafts or cash deliveries to petitioner Ash for betting on college football games during the 1967 Fall season. It is also undisputed that Ash delivered substantial amounts of this cash to petitioner Cannon. Ash represented to Hodges that he was placing the bets with Cannon as a bookmaker. Cannon acknowledged receipt of between $11,000 and $12,000 during this period of time from Ash.

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Cannon reported gambling net income of $15,040 for the year 1967 of which $7,000 was shown by his return to have been received prior to the two months in question. Cannon testified that all of the receipts which remained as net profits from his gambling during the year went into a shoe box and the sum of $15,040 was left in the shoe box at the end of the tax year or had been represented by cash deposits in the bank during the year. Cannon testified that he had voluntarily given to Hodges the sum of $5,000 in December 1967 when Hodges got in touch with him personally and made a plaint that he was in dire difficulties because of his embezzlements, and Cannon claims that this $5,000 should have been deducted from any amount which he otherwise would owe on his gambling receipts.

The Tax Court, very properly we think, after having read the testimony, stated in the following terms:

> "The record in this case is unsatisfactory. Neither Ash nor Cannon had records to prove the amounts of cash they handled. The testimony of each was vague, unconvincing and entitled to little weight. The testimony of other witnesses lent little support to the contentions of either Ash or Cannon. The activities of both Ash and Cannon were illegal and the money that changed hands was embezzled from a bank. The $5,000 paid from Cannon to Hodges resembles hush money."

The Tax Court then without making specific findings, as it could not under the testimony then before it, made the following conclusion:

> "Given such a record, we conclude that both parties failed to prove how much income they earned as a result of their illegal gambling activities with Hodges ill-gotten gains. Respondent admits an inconsistent position and acts as a stake holder. It would, therefore, seem inappropriate to tax both Ash and Cannon on the entire $64,680. Accordingly we hold that Ash and Cannon each earned one-half of the total sent from Hodges to Ash, or $32,340."

As conceded by counsel for one of the respondents:

> "Of course, the Commissioner was always entitled to the presumption against both parties that his determination was correct."

This proposition has been clearly established since *Helvering v. Taylor*, 293 U.S. 507, 55 S.Ct. 287, 79 L.Ed. 623 (1934) when the Supreme Court stated:

> "Unquestionably, the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid." Citing *Lucas v. Structural Steel Co.*, 281 U.S. 264, 271, 50 S.Ct. 263, 265, 74 L.Ed. 848, 849 and *Wickwire v. Reinecke*, 275 U.S. 101, 104, 48 S.Ct. 43, 44, 72 L.Ed. 184, 185 and *Welch v. Helvering*, 290 U.S. 111, 115, 54 S.Ct. 8, 9, 78 L.Ed. 212, 215.

Such a requirement is not met if the proof adduced before the Tax Court is insufficient to permit that Court to find that as to either or both of these petitioners the Commissioner's determination was erroneous. In dealing with this problem the Court of Appeals for the First Circuit, in *United States v. Rexach* had the following comment to make:

> "First, language regarding the Commissioner's obligation to prove the existence and amount of the deficiency apparently stems from *Helvering v. Taylor, supra*, which held that once a taxpayer in a deficiency case has borne his burden of proving the Commissioner's determination invalid, he has no further obligation to show that no money is owed, or, if some, how much. But this happy state is reached only if the predicate is fulfilled, i. e., *only if* the taxpayer has carried his burden of persuading the factfinder that the deficiency was erroneous. 293 U.S. at 513, 514, 515, 55 S.Ct. 287, 79 L.Ed. 623. [Emphasis in original.] 482 F.2d 10, 17 n. 3 (1st Cir. 1973).

Since we conclude that the Tax Court was justified in not relying on the conflicting testimony of either of these petitioners in the two cases which were consolidated for hearings before that Court, this would justify the legal result of having the total amount taxed as income to both of the petitioners. The fact that the Tax Court ameliorated this condition by entering a decision for one-half of the amount as against each petitioner is certainly not a matter which either petitioner can here complain of.

Cannon asserts that even though the Tax Court could approve an assessment against him based upon receipt of income amounting to $32,340 this amount should be reduced by the sum of $15,040 already reported by him as income from gambling. The trouble with this is that the record clearly discloses that some $7,000 of the amount which he reported was represented by deposits in bank accounts made prior to the two months with which we are here concerned. Furthermore, Cannon's testimony is so vague and uncertain and unreliable that the Tax Court would not have had to accept a positive assertion by him, which he did not in fact make, that any amount of the monies received by him during October and November were a part of the $15,040 reported by him on his return. He did state in general terms that the $15,040 represented his entire net income from gambling for the ye.

[2] Cannon also claims that the $5,000 payment which he made to Joe Hodges in December of 1967 should not be included in income received by him during that year. There is, of course, no basis for this contention. The testimony shows without dispute that this amount was voluntarily given by him to Hodges. It was no part of any legal obligation and if it was in the nature of a compulsory payment, the Tax Court found it to be in the nature of "hush money" which is not a deductible item.

The decision of the Tax Court is AFFIRMED.

CLARK, Circuit Judge (dissenting):

The Tax Court's equitable allocation cannot be justified by either the law or facts of this case. In approving this Solomonic approach, the majority tacitly exacerbates the difficulties inherent in the use of alternative inconsistent deficiency assessments and fails to credit the two credible items of proof adduced at trial. I respectfully dissent.

The majority correctly states that in the ordinary case the Commissioner's assessments are presumed valid until shown by the taxpayer to be erroneous or arbitrary. Likewise it cannot be seriously questioned that the Commissioner has the right to make inconsistent assessments in order to protect the fisc and insure against a potential "whipsaw" effect.[1] *Estate of Goodall v. Commissioner*, 391 F.2d 775 (8th Cir.), *cert. denied*,

1. "A whipsaw situation occurs in the tax field when two different taxpayers take positions with respect to a particular transaction which are so inconsistent with each other that only one should logically succeed—and yet, because of jurisdictional or procedural reasons, first one and then the other prevails against the Government." *Remarks by Phillip R. Miller at*

393 U.S. 829, 89 S.Ct. 96, 21 L.Ed.2d 100 (1968); *Malat v. Commissioner of Internal Revenue*, 302 F.2d 700 (9th Cir.), *cert. denied*, 371 U.S. 934, 83 S.Ct. 308, 9 L.Ed.2d 271 (1962).

What provokes me to dissent is that the majority applies these two principles in tandem to conclude that the Commissioner was entitled to recover the full amount against both taxpayers and that the Tax Court's amelioratory action in reducing the liability by half cannot be complained of on appeal. By consolidating the cases, the Commissioner gained protection against any deleterious effects the taxpayers' conflicting stories might have on his ability to collect the full amount from someone. With all the parties before it, the Tax Court could insure that the public would not lose tax revenues and that the Commissioner would not receive a windfall by recovering tax on the same income from two taxpayers. As the Commissioner readily concedes, the inconsistent assessments are merely a mechanism to guard against loss, not a procedural device to permit double recovery.

This court has never had occasion to decide the legal effect that should be accorded inconsistent assessments in a consolidated proceeding such as this. However, several cases have enunciated the rule that an arbitrary assessment is stripped of presumed validity. *See, e. g., Lucia v. United States*, 474 F.2d 565 (5th Cir. 1973) (en banc). *Bar L. Ranch, Inc. v. Phinney*, 426 F.2d 995 (5th Cir. 1970). In one sense, the assessments against Ash and Cannon are not arbitrary because the Commissioner had a factual basis for believing that either one or the other had received gambling income. However, the presumption clearly becomes irrational and arbitrary the moment it is extended to both taxpayers simultaneously in a consolidated proceeding. *Cf. Tot v. United States*, 319 U.S. 463, 63 S.Ct. 1241, 87 L.Ed. 1519 (1943); *Mobile, Jackson & Kansas RR Co. v. Turnipseed*, 219 U.S. 35, 31 S.Ct. 136, 55 L.Ed. 78 (1910). At most, the Commissioner should be treated as a stakeholder and the dual assessments should mean only that the Commissioner's either-or determination is entitled to presumptive validity by the Tax Court to the extent of asserting that one or the other or both of the taxpayers together owe a single full recovery. Anything more is per se arbitrary and unfair.

If this were a true "whipsaw" situation involving separate proceedings against competing taxpayers where no credible evidence bearing on allocation could be ascertained, we would be faced with a different and more difficult question. It is not. Even conceding that neither taxpayer's whole story was worthy of belief, the court had before it reliable proof constituting a rational basis for the distribution of liability. That proof consisted of clear documentation that Ash received the $64,680 and Cannon's admission that $12,000 of that sum was wagered with him.[2]

The Tax Court itself decided and the majority agrees, as I do, that the remaining proof was unworthy of belief. Thus there is simply no credible basis for assuming that half of the total was transferred to Cannon, or that the remaining half was retained by Ash. My concern with affirming their decision to "divide the baby" is that I cannot discern any good reason for disregarding the probative evidence which was developed in favor of an "equitable" solution which has *no* factual foundation. With deference, I suggest that the proper resolution of this controversy would be to remand to the Tax Court for an allocation of $12,000 to Cannon and $52,680 to Ash.

Court of Claims Judicial Conference, October 14, 1971, on Whipsaw Problems in Tax Cases, 25 The Tax Lawyer 193 (1972).

2. I agree that Cannon's asserted defenses of payment of the tax and a bribe expense to discount his liability are both totally meritless.

APPENDIX D

UNITED STATES TAX COURT
APR 1972

UNITED STATES TAX COURT

IDUS P. ASH AND GEORGIA L. ASH,)
Petitioners,)
V.) DOCKET NO. 360-71
COMMISSIONER OF INTERNAL REVENUE,)
Respondent)

MOTION FOR LEAVE TO AMEND PETITION

The Petitioners, pursuant to Rule 17 (b) (2), hereby move the Court for Leave to Amend the original Petition filed by Petitioners and to substitute in lieu thereof the Amended Petition, attached hereto as Exhibit "A", and as grounds for said motion would show the Court as follows:

1. The original Petition herein was filed with the Court on January 14, 1971. At issue in the case is whether the Petitioners should be taxed on some $64,680.00 which they received from one Joe H. Hodges. In the original Petition it was alleged (Paragraph 5 (a)) that the Petitioners "merely cashed the gambling payments and passed them on to others as the agent for such persons and served only as a conduit in the transactions." At the time the original Petition was filed, the Petitioners had previously secured as of April 23, 1969, an affidavit from Joe H. Hodges to the effect that all funds transmitted to Petitioners were used by them to pay gambling debts of Joe H. Hodges with

one M. Ralph Cannon of Dallas, Texas.

2. At the time the Petition was filed, and at the time the initial affidavit was secured, Joe H. Hodges was incarcerated in Federal institutions at Texarkana, Texas, and Leavenworth, Kansas, respectively.

3. The first time that Petitioners or their counsel were able to discuss with Mr. Joe H. Hodges his testimony in this matter was on November 8, 1971, and said discussion was conducted in the presence of representatives of the Respondent. At such conference, it was revealed that the funds transmitted by Joe H. Hodges to Petitioners, and which are here sought to be taxed to Petitioners, had as their source, embezzlement by Joe H. Hodges from the Meyerland State Bank, Houston, Texas, and further that the greater portion of the funds involved had been personally picked up from Petitioners by Joe H. Hodges in Dallas, Texas, and taken to Los Vegas, Nevada, for gambling, rather than being transmitted to persons in the Dallas, Texas area in payment of gambling debts or for purposes of wagering. It was further revealed that on October 8, 1971, the Internal Revenue Service had assessed against Joe H. Hodges federal income taxes with respect to all funds embezzled from the Meyerland State Bank, which funds were the same as those transmitted to Petitioners to be held for Joe H. Hodges.

4. Petitioners therefore desire to amend their Original Petition so as to more specifically allege the person or persons for whom they acted as agent or conduit in the transmission of funds alleged to be taxable to Petitioners.

WHEREFORE, it is prayed:

1. That the Court grant this motion to permit Petitioners to file the Amended Petition attached hereto.

2. That the Court consider this motion in conjunction with Respondent's "Motion to Calendar and Consolidate, Or In The Alternative, Continue", together with "Petitioners' Memorandum in Opposition to Respondent's Motion to Calendar and Consolidate, Or In The Alternative, Continue", both of which will be considered by the Court on May 10, 1972, at which time they have been calendared for hearing.

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APPENDIX E

UNITED STATES TAX COURT
APR 21 1972
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UNITED STATES TAX COURT

IDUS P. ASH AND GEORGIA L. ASH,
Petitioners,

V. DOCKET NO. 360-71

COMMISSIONER OF INTERNAL REVENUE
Respondent.

AMENDED PETITION

The above named Petitioners hereby file their amended petition for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (AP:D:90) dated October 16, 1970, and as the basis for their case allege as follows:

1. The Petitioners are individuals, who reside at 1003 High School Lane, Irving, Texas. The return for the period here involved, the calendar year ending December 31, 1967, was filed with the District Director of Internal Revenue, Dallas, Texas.

2. The Notice of Deficiency (copy of which was attached to the original petition and marked Exhibit "A") was mailed to the Petitioners on October 16, 1970.

3. The deficiency determined by the Commissioner is for income taxes for the calendar year 1967 in the amount of $27,305.86, all of which proposed deficiency is in dispute.

EXHIBIT A

4. The proposed tax deficiency set forth in the said Notice of Deficiency is based upon the following erroneous adjustments:

(a) Petitioners did not receive gambling payments in the amount of $64,680.00;

(b) Petitioners were not subject to the self-employment tax of $422.40;

(c) Petitioners were entitled to a medical expense deduction of $920.00;

5. The facts upon which the Petitioners rely as the basis of this case are as follows:

(a) Petitioners received in 1967 Western Union money orders from one Joe H. Hodges in the amount of $64,680.00. These Western Union money orders were cashed and held by Petitioners for the benefit of Joe H. Hodges, and said funds were either subsequently picked up by Hodges or Hodges directed that Petitioners transmit the funds to other persons in payment of gambling debts or as wagers on behalf of Hodges. Some part of such funds, the exact amount being unknown to Petitioners, was transmitted to one M. Ralph Cannon in payment of gambling indebtedness from Joe H. Hodges to M. Ralph Cannon or as wagers. M. Ralph Cannon is Petitioner in a case docketed with the Tax Court, Docket 6102-71, wherein the Respondent, Commissioner of Internal Revenue, is contending that the full amount of the same funds received by Petitioners herein from Hodges (namely $64,680)

should also be treated as the income of M. Ralph Cannon. All funds received by Petitioners herein were not the property of Petitioners nor intended as any form of compensation to Petitioners, who at all times held such funds as agent for Joe H. Hodges or acted as a conduit for Joe H. Hodges in the payment of some portion of the funds to M. Ralph Cannon. All funds transmitted by Joe H. Hodges to Petitioners had as their source, funds embezzled by Joe H. Hodges from the Meyerland State Bank of Houston, Texas. Petitioners had no knowledge that the funds involved had been embezzled from the Meyerland State Bank, and in no way participated in any embezzlement from said bank. Joe H. Hodges has been previously convicted for his actions in this regard. Furthermore, the Internal Revenue Service has included in the taxable income of Joe H. Hodges for 1967 the embezzled funds from the Meyerland State Bank in the amount of $144,292.96. It is these same funds which the Internal Revenue Service now seeks to include as taxable income of Petitioners. Taxes with respect to the embezzled income were assessed against Joe H. Hodges on October 8, 1971.

(b) The Petitioners were not engaged in the trade or business of accepting wagers nor did they use the payments for their own benefit, hence, the payments did not constitute taxable income of Petitioners.

(c) For the reasons set forth in (a) and (b) above, the Petitioners were not subject to the self-employment tax and were entitled to the medical expense deduction claimed on their return.

WHEREFORE, the Petitioners pray that this Court may try the case and find that the Petitioners should not be taxed on an additional $64,680.00 in income; that Petitioners are not subject to the self-employment tax; that the medical expense deductions were properly claimed and rule that the Commissioner should not assess a deficiency in the amount of $27,305.86 with regard to these issues.

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